

VIII. EVALUATION OF REFORMS IN OTHER STATES

California has not been the only state faced with significant workers' compensation cost increases and market disruptions in recent years. Several other jurisdictions experienced dislocations similar to, though perhaps not as severe as, those in California. Much can be learned regarding the long term effects of reform and potential savings to the system from states with reform efforts that preceded those in California.

Looking to other states for successful reform measures

California can look at other states in order to gauge how effective the reforms ought to be in providing measurable cost savings, given delays in seeing the full impact of the reforms and the possibility of future reforms. However since all states vary substantially based on their individual regulatory structures, litigation histories, size, and demographics, it is difficult to make one-to-one comparisons. Notwithstanding, there are a few major successful reforms in other states that California may want to analyze in more detail to see if these reform structures are relevant for California. For instance, Texas has been successful in decreasing the number of fraudulent claims and litigation by adopting a lump-sum payment system for their attorneys. North Dakota has been unusual in adopting cost-sharing techniques on behalf of the injured worker. These same techniques are known to create appropriate incentives for reduced utilization of healthcare services in traditional group coverage and appear to have done the same for injured claimants in North Dakota.

Sources of Information and methodology

Given the complexity of the workers' compensation system, we performed an extensive literature review to identify the challenges and alternative solutions for keeping California's system sustainable in the future. Our research is derived from the following sources:

- **Governmental Entities:** reports published by each state's respective regulatory body, including: California's Division of Workers Compensation (DWC), Florida's Office of Insurance Regulation, Illinois' Workers' Compensation Commission, Maine's Bureau of Insurance, Department of Professional Financial Regulations, Michigan's Office of Financial and Insurance Services, Minnesota's Department of Labor and Industry & Department of Commerce Insurance, Oregon Department of Business & Consumer Services, Workers' Compensation Division, and Texas' Department of Insurance, Division of Workers' Compensation;
- **Regulator Interviews:** conducted with representatives from Florida, Michigan, Minnesota and Texas;
- **Economist and Workers' Compensation Research Specialist Interviews:** conducted with health economists and workers' compensation research analysts (i.e. Nera Economic Consulting, University of California, Berkeley and Davis faculty, the California Workers' Compensation Institute); and

- **Policy Think Tanks and Journal Publications:** reviewed research derived in reports (i.e. Workers' Compensation Research Institute, California Healthcare Foundation, Public Policy Institute of California and California Workers' Compensation Institute).

We interviewed individuals with detailed knowledge of environments in other states that have introduced significant legislative reform. Regulators, State Fund executives and independent rating bureau managers were included among those interviewed. Each state has achieved a reasonably stable workers' compensation market in the post reform era. Similar to California, each has a competitive state fund, though in most cases, a separate market of last resort is maintained.

In addition to the states identified above, we also considered the post reform experiences of two exclusive state fund jurisdictions – North Dakota and West Virginia. Both states implemented substantive adjustments to workers' compensation benefit levels during the last decade. Though, the environment in West Virginia is still evolving, North Dakota has been successful in generating a stable system with some of the lowest workers' compensation rates in the country.

Though each of the states included in our evaluation experienced marketplace dislocations that were similar in some respects to the situation in California, the particular circumstances varied among the jurisdictions. Regulatory responses were crafted to reflect local circumstances.

One common theme in all of our discussions was an emphasis on the need for patience to make possible an evaluation of the full impact of the reforms. As can be seen in the exhibit below other states have had multiple years to realize full impacts of major legislation passed.

Exhibit VIII.1. Other State's Major Legislation		
State	Major Legislation	Year
Florida	Major Reform Acts	1993, 2003
Illinois	House Bill (HB) 2137	2005
Maine	Reform Act, LD 1909	1992, 2004
Michigan	Workers Disability Compensation Act, amendment	1995
Minnesota	Reform Legislation	1992
Oregon	HB 2900, HB 2271, Senate Bill (SB) 1197	1987, 1987, 1990
Texas	HB 7	2005

Also stressed was the importance of cooperation between the two primary stakeholders: (1) employers and labor and (2) vendors and other parties with an interest in the workers' compensation system. An additional issue repeatedly mentioned was the potential benefits of appropriate regulation to assure a competitive and solvent workers' compensation insurance marketplace.

Key Issues regarding Reforms

Increasing Costs

Escalating costs were the overriding issue that generated the need for reform in all of the states we reviewed. Medical cost increases, and increases in the use of legal representation were identified as important factors in most of the states we surveyed. In some cases, cost increases associated with indemnity claims were as important as medical inflation – particularly in states that had cost of living adjustments (COLAs) associated with the underlying benefit structure. In addition, the lack of objective standards for rating permanent disability (PD) claims was a major cost driver in some jurisdictions. All of these states experienced major increases in premium levels and decreasing numbers of carriers participating in the marketplace.

Several of the states also experienced large increases in system costs outside of the benefit structure itself. These costs include residual market loads (RML's), assessments, and increased regulatory expenses particularly in the legal and court process. Some states also experienced medical cost shifting into the workers' compensation system due to the lack of effective fee schedules and cost containment processes. The resulting inefficiencies tended to generate cost increases for individual employers that extended beyond the price of workers' compensation coverage itself. Individual employers were confronted with the need to spend significant time and effort to find and place cost effective coverage for their operations.

Insurer Response

The general consensus among the individuals we interviewed was that insurers responded favorably to reforms as the actual impact became evident. Rate levels tended to stabilize and then decline, carriers attempted to increase market share, previously inactive carriers reentered the market, and the market of last resort was reduced in size. The increased level of competition that emerged after the reforms generated benefits for all parts of the workers' compensation system.

Cooperation Among Stakeholders

The reforms in many states resulted in increased cooperation among the various groups with a vested interest in the workers' compensation system. In several states, advisory committees were formed with both labor and employer representation to provide advice to regulators and legislators on workers' compensation issues. This structure provides a forum to discuss system related issues and the potential implications of any proposed changes.

The increased level of cooperation resulted in greater communication among the stakeholders which helped to further stabilize the system and promote long term fairness to all interested parties.

Roll back of reform provisions

Most states were faced with attempts to roll-back or modify some aspects of the reforms. The consensus among the individuals we interviewed was that significant legislative modification of the reforms would be premature until the full impact of the changes could be effectively and appropriately evaluated. In general, respondents indicated that the pressure to roll-back change tended to decrease as the full impact of the reforms was understood by the legislative leaders and regulators.

Several of the states faced legal challenges to the workers' compensation reforms as implemented. The ultimate impact of judicial decisions on costs is difficult to anticipate and can be significant.

Monitoring Competition

Some states implemented procedures to evaluate the level of competition in an effort to monitor the state of the marketplace. We offer two examples:

The "Status of Competition" report published by the Compensation Advisory Organization of Michigan (CAOM) addresses three general areas:

- Market Structure – the number and size distributions of buyers and sellers, barriers to entry, cost structures, availability of information to interested parties, and the degree of product differentiation.
- Market Conduct – overall price levels and trends in rate changes, size of the market of last resort, and variability of rates by class.
- Market Performance – price, profit and output levels, the degree of cost efficiency, and the rate of technological progress.

The "Workers' Compensation Premium Rate Ranking" report published by the Oregon Department of Consumer and Business Services provides a comparison, normalized to Oregon's class distribution, of rates for all fifty states. The study was implemented in the mid 1980's when workers' compensation premium levels in Oregon were among the highest in the country. The most recent survey suggests that rates in that State fell to the bottom 20% by 2004.

Reinsurance

The reinsurance marketplace has an impact on the primary carriers in a specific state. Their willingness to provide broad coverage and timely payment of recoverable is closely tied to the stability and predictability of the states system. The positive support of the reinsurance market also assists in the reentry of primary carriers into a state after reforms.

One state (Minnesota) that we interviewed has created a monopoly re-insurer for their states exposures. The results are very positive and are viewed as a critical to the continued stability of the system in their state.

Unique state reforms to learn from

To come up with our findings we performed a comparative state analysis from unique reforms enacted or studied in the following states: Florida, Illinois, Maine, Michigan, Minnesota, New York, Oregon, and Texas.¹ Cost-sharing techniques have been utilized by managed care organizations since the 1970s; when the cost of the medical service is shared between the party receiving the service and the party paying for the insurance. Common forms of cost-sharing techniques are deductibles and co-payments and their purpose is for the parties to not over-utilize medical services. North Dakota is the only state that utilizes cost-sharing techniques on the part of the employer, in the form of a medical deductible.² The reforms in North Dakota were enacted in 1999, and North Dakota has seen a slight decrease in the number of claims filed and the cost of claims. A second regulatory option could be to implement a system where Monday morning workers' compensation claims are audited at a greater rate than claims filed on other days of the week, a process that Texas has used. Unfortunately, we do not have quantifiable evidence from Texas; however the benefits can include early identification of fraudulent claims and overall decreased claim costs.

Both in California and Oregon state regulators have attempted to pilot 24-hour care plans. These plans combine work-related injury medical care (i.e. workers' compensation insurance) with non-occupational medical care (i.e. group health insurance). The benefits of a coordinated health system include increased administrative cost savings, reduction in marketing costs and increased savings from preventive care and coordinated pricing for medical services, for example both occupational and non-occupational medical services already currently use the same fee schedules. In the 1990s the Robert Wood Johnson Foundation funded projects to test whether 24-hour plans are cost-effective alternatives to the current system. In the pilot program there was still a preservation of separate workers' compensation and general group health insurance policies, and capitated payments were in place. Unfortunately, due to low enrollment in the pilot programs, the states observing decreased claim costs and increased participation in group health insurance by the general population, the pilot programs were phased out.³ Theoretically there is reason to believe that 24-hour plans would reduce over-utilization of medical services and lead to an overall decrease in healthcare spending. Further, in the course of our research everyone from brokers, claims administrators, researchers, employers, economists and injured workers agree that these plans must be piloted and evaluated in order to fully comprehend the potential cost savings. After giving ample time for both the newly implemented reforms to react and the current insurance market to settle, one could consider evaluating the possible savings of 24-hour care plans.

Additionally, Texas was successful in adjusting attorney's compensation through a lump-sum payment system. In order to combat Texas' increasing litigation costs the state passed a reform that limited the contingent fees attorneys could receive for litigating a workers' compensation case, because the state viewed an unfavorable relationship between attorneys and the system. If legislators found a similar, unfavorable atmosphere in California, re-structuring attorney payments options could provide potential benefits, such as a significant reduction in litigation, decreased incentives for attorneys and healthcare providers to abuse the system, resulting in cost savings to the entire system.

Other states learn from California

Just as Californians learn from other states, other states have begun to look to California as well. For instance, Governor Pataki of New York has announced his workers' compensation reform plan that urges New York to look at California's notable successes: increasing penalties for insurance fraud, adopting a pharmaceutical fee schedule, enforcing employers to pay claims on-time and removing the employees right to bring civil action for penalties, to help decrease New York's escalating costs. New York suffers from high administrative costs and increasing costs due to the lack of limitations on disability benefits. The latter cause of high costs, lack of limits of benefits, is also something that California still suffers from because injured workers technically can collect benefits until their death.

Criteria for evaluating reforms

We constructed potential solutions to California's workers' compensation challenges based on the research gathered from these sources, and we evaluated these options against the mission and goals of the California Department of Insurance (CDI), the Division of Workers' Compensation (DWC), the California Commission on Health and Safety and Workers' Compensation (CHSWC) and the state legislature. All are dedicated to assuring security, safety and recommending necessary ramifications for improving the quality and efficiency in the WC system.⁴ We have developed recommendations based on this dedication and the following criteria:

- **Minimize the cost** of workers' compensation claims and administrative operations;
- **Improve the quality** of service received by employers and injured workers;
- Minimize political controversy; and
- **Minimize incentives** for increased litigation, healthcare provider loopholes and fraud.

Key Findings: Policy Options to Consider

Through AB 227, SB 228 and SB 899 the California Legislature has made progress towards achieving its goals of cost containment and improving satisfaction of stakeholders. Unfortunately, there is still room for improvement in the competitive WC insurance market and there is still the risk, as with general health insurance, that costs could increase to unsustainable levels. Where universal health coverage for all Americans is not politically feasible, the solution might be in addressing the cost drivers of workers' compensation claims, very similar to how managed care has reacted with options for group health insurance. To improve cost efficiency and reduce incentives for litigation, loopholes and fraud, the state may want to further study alternatives such as:

- Implementing Cost-sharing and Claim Audit Techniques;
- Designing and Piloting 24-hour Care Plans;
- Researching Attorney Payment Limits; and
- Considering Alternative Rating Methods.

Justification for scoring

Appendix K includes a State Reforms Comparative Analysis. Due to time, budget and scope limitation we were not able to complete a thorough state by state analysis. Presented in the appendix is a snapshot of a few handpicked states and their specific state characteristics. Moving forward a state by state smart practices exercise could provide substantial insight into reform measures that have succeeded and those that have not. A smart practices exercise would evaluate each of the fifty states on comparative reforms and in the end one can draw conclusions based on trends observed.

Projecting the Outcomes

We have evaluated the four policy options proposed earlier and projected outcomes for them according to each of the above criterion, based on evidence from the data sources mentioned in the ***Sources and Methodology*** section. Evidence gathered for the alternatives is qualitative in nature at this point and therefore requires a great degree of subjectivity. However, objective and quantifiable evidence could be gathered through additional research and analysis. Our results are summarized in Exhibit 3 below.

Exhibit VIII.2. Ranked Criteria and Weighted Scores					
Policy Option	Minimize claim cost & admin operations (Weight = 3)	Minimize incentives for litigation, loopholes & fraud (2)	Minimize Political Controversy (1)	Improve quality of service (1)	Total
Cost-sharing & Audit Techniques	++ (3*4)	+/- (2*2)	+/- (1*2)	+/- (1*2)	12+4+2+2 = 20
24-hour Care Plans	+/- (3*2)	+/- (2*2)	+/- (1*2)	+ (1*3)	6+4+2+3 = 15
Attorney Payment Limits	+/- (3*2)	++ (2*4)	- (1*1)	+/- (1*2)	6+8+1+2 = 17
Alternative Rating Methods	+/+ (3*4)	+/- (2*2)	+/- (1*2)	- (1*1)	12+4+2+1 = 19

(+ indicates "favorable", - indicates "unfavorable", +/- indicates "undetermined", ++ indicates "very favorable" and -- indicates "very unfavorable")

In projecting the outcomes we rank our criteria on a scale of importance. We feel that minimizing claim and administrative costs are the most relevant criterion and reducing incentives for litigation, health provider or injured worker loopholes and fraud is of second greatest importance. Both minimizing political controversy and improving the quality of service for employers and injured workers follow at equal levels of importance. The decision to rank cost savings the greatest is solely based on the charge of this report, to accurately identify and recommend cost saving measures. Next, we assign weights to our rank order, and apply a weight of three (3) to our most important criterion, cost savings, a two (2) to reducing incentives, and equal weights of one (1) to minimizing political controversy and improving quality of service. Exhibit x above summarizes our results illustrating alternative rating methods and cost-sharing techniques as policy options with the highest scores.

Observation: Next Steps

Moving forward we observe California should evaluate the workers' compensation reform successes from other states, determine their relevance to California, identify limitations to their implementation within our state, and propose new legislation.

Chapter VIII Endnotes

¹ See State Reforms Comparative Analysis in Appendix K for detailed information on each state's experience

² North Dakota uses cost-sharing techniques aimed at the employer

³ Dembe, Allard; Understanding Workers' Compensation Medical Care in California, The California Healthcare Foundation, June 2005, pp. 1-42

Neuhauser, Frank; In-person interview, University of California, Berkeley, December 2005
Biennial Report on the Oregon Workers' Compensation System, January 2005, pp. 1-121

⁴ Department of Industrial Relations; CHSWC and DWC